

The darkest hour of the night comes just before the dawn.

The travails of the German economy are well documented, with even The Economist running a front cover depicting it as the new sick man of Europe. Unfortunately for Europe, German GDP accounts for over 29% of the region’s overall GDP so the fate of the two are closely intertwined.

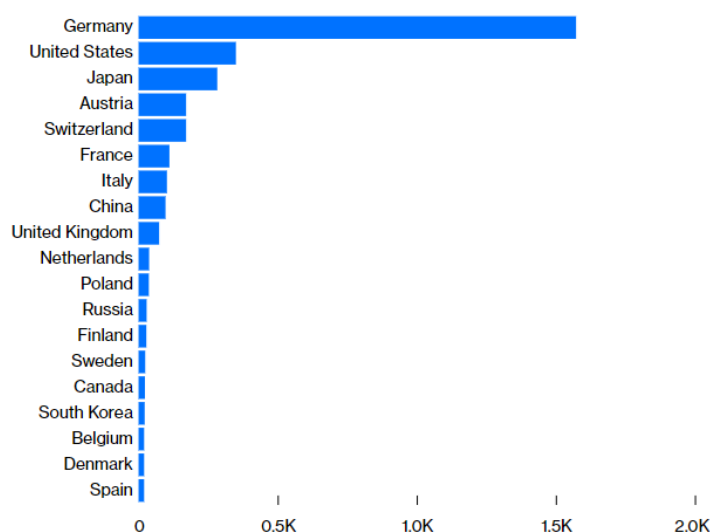
One of the pillars of the strength of Germany over the past twenty years is their industrial sector, which account for 27% of the country’s GDP. This is dominated by the automotive, chemical, pharmaceutical, and engineering sectors. The pandemic hit the heart of the German economy hard, and the invasion of Ukraine laid bare the failing of its energy policy started by Gerhard Schröder - he was a strong advocate of Nord Stream 1, allowing Germany to buy gas directly from Russia, before becoming employed by Gazprom and Rosneft. The reliance on imported energy was increased when Angela Merkel’s party decided to lose all the country’s nuclear power plants in the wake of Fukushima and under pressure from the powerful green lobby, close all the coal power plants by 2030.

Prior to the ban on energy imports from Russia, this import based energy policy had resulted in Germany having a long period of power supply costs around half of its neighbouring countries. This however has now reversed, and its companies are facing power costs double that of France.

Germany’s Mittelstand has built itself on making a single piece of equipment, which few have even heard of, yet is essential for goods worldwide and is slowly but steadily perfecting that product. This model has proved to be successful throughout the digital and climate changes over the past decades; however, cheap power was one of the key components enabling this strategy to work effectively, and this now seems to be undermining the beating heart of the German economy. Despite this headwind, the Mittelstand has been built by generations of entrepreneurs, and if anyone can successfully adapt to green energy in a cost-efficient manner, these men and women are likely to be on the shortlist.

No one does it quite as well as the Germans

From 2015 to 2020, the number of German hidden champions grew by one-fifth; most are family firms that have existed for an average of 70 years.



Source: "Hidden Champions," Institute of German Economics, 9/2022
 Note: Relatively unknown companies that rank in the top three of their global markets or first on their continent, with annual revenues of less than \$5.5 billion.

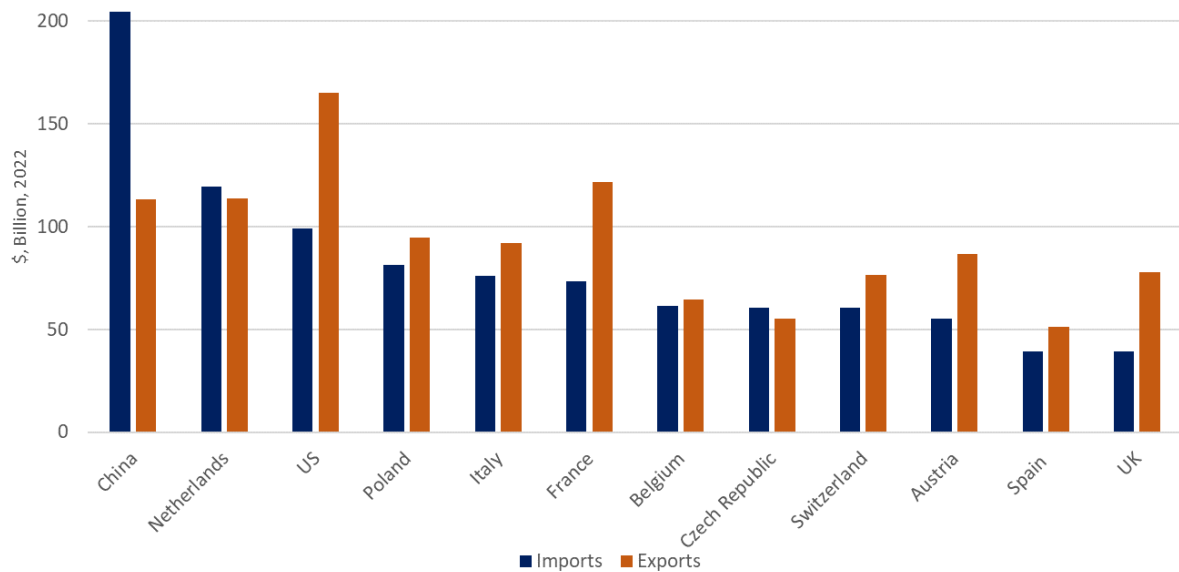
Source: Bloomberg



These specialised companies provide Germany with an economic cushion, even in times when Chinese and American companies are pulling back on European investment given the specialised nature of their product sets. This is particularly important as the Mittelstand accounts for 90% of all German companies and employs 57% of the total workforce, a statistic unparalleled in any other economy.

Global trade is what Germany is renowned for, and the Mittelstand has been a key part of establishing Germany's place on the global stage. However it also relies on the effective functioning of its fortune 500 companies such as Siemens, BASF, SAP and the Auto manufacturers and it is these companies which currently are finding dirt in their spark plugs.

Germany's major trading partners, 2022

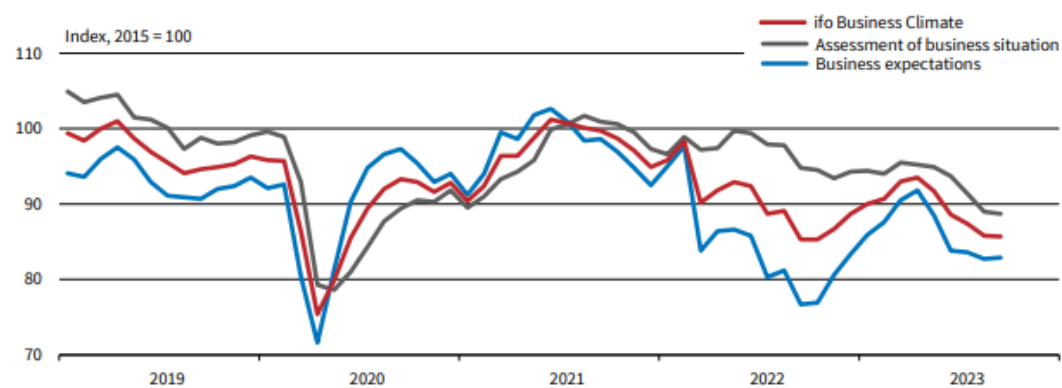


Source: TIM/UN COMTRADE

While it would be very easy to write off the German economy, as the world did in the early 2000's when it was labelled the 'sick man of Europe' as the so call German economic miracle post reunification petered out, it is worth remembering that it only suffered a short recession in 2003 before returning to growth. It is often, when the night seems at it darkest, when improvements go unnoticed and most of the most recent economic data coming out of German seems to be dismal.

ifo Business Climate Germany^a

Seasonally adjusted



^a Manufacturing, service sector, trade, and construction.
Source: Ifo Business Survey, September 2023.

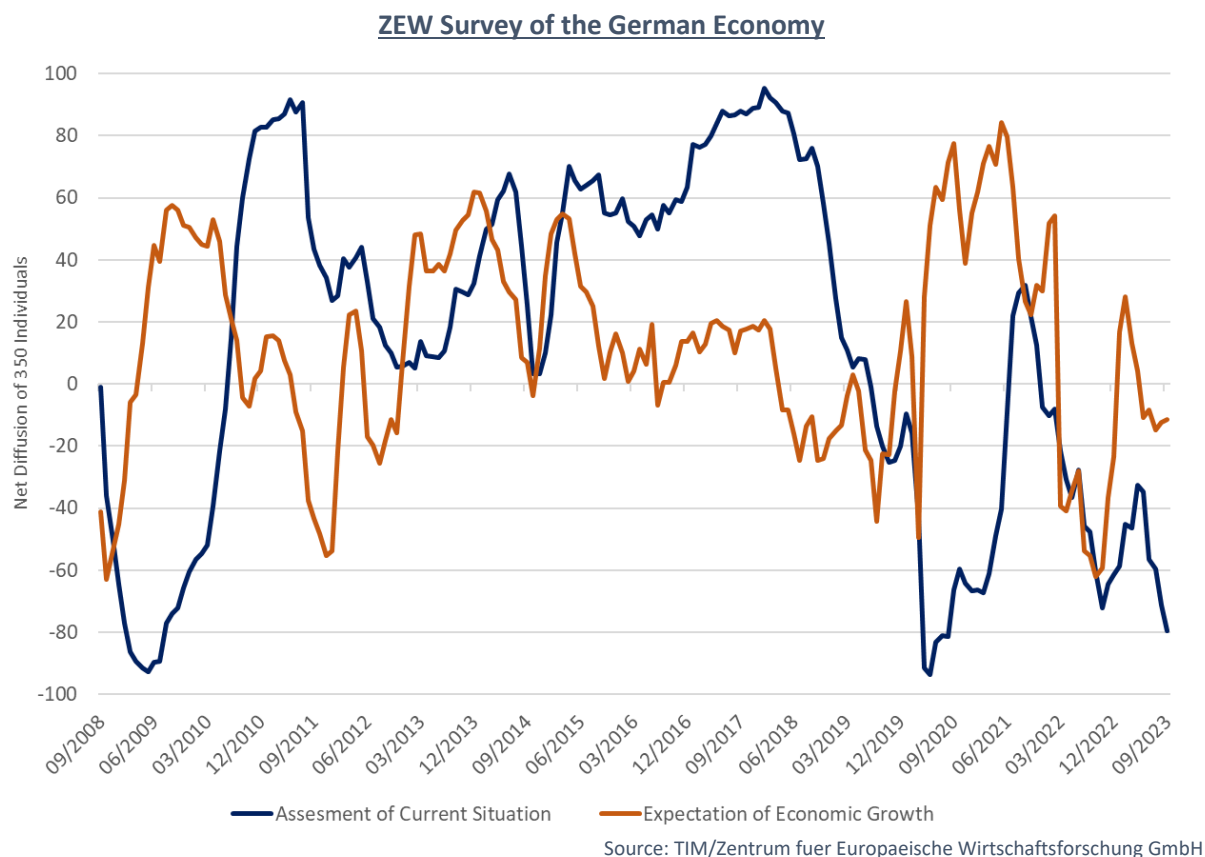
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Capital at Risk – the value of investments can fall as well as rise and you may not get back what you invested

Past performance is not a reliable indicator of future results.

However, the latest ZEW survey did show a slight improvement in expectations of economic growth, despite current orders, and the assessment of the current situation being close to the pandemic and financial crisis lows and while the reading was still sub-zero, it shows that the balance of the 350 experts from banks, and financial departments of selected corporations interviewed are turning less bearish, which should slowly lead to an improvement in investment, which looks dreadful at the moment.



The Royalist cleric, Thomas Fuller, wrote while avoiding capture during the English Civil War, “*The darkest hour of the night comes just before the dawn*”, and it is likely that investors and economists may miss the first rays of sunlight coming over the Rhine, as the night certainly seems dark at the moment. We believe, that like many and English football fan knows only too well, it is a foolish errand to write off the Germans too soon, and that the unique nature of its economy is more robust than many give it credit for and any once the Chinese economy comes out of its slumber, the German economy is likely to find the spare part to fix its currently fault accelerator pedal.

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